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SWFs and Egypt: A Fresh Look at Infrastructure Funding and Investments

By [Asim Ali]() and [Shatha Al-Aswad]()[1]

Abstract: This paper argues that "neighborly investment" by the Persian Gulf states and their SWFs – in the post-political transitioning but financially distressed and capital-starved Egypt and other countries in the region – would be a positive step towards their diversification and development objectives. Focusing their investments on generating tangible stakes in a maturing economy where future capital flows can enhance the long-term targets of their SWFs rather than building intangible stakes in ailing economies where the outcome is vague and the prospect of growth is marginal.

Introduction

The popular uprisings against autocratic governance, which began in Tunisia, became a revolutionary spark for the democratic aspirations of people in the Middle East, including Egypt. Once the political protests erupted over demands for political rights and equitable socio-economic opportunities throughout Egypt, Hosni Mubarak's 30-year rule came to an end. Since then, political and institutional paralysis has led to significant economic disruptions, which continue to cloud the economic transition.[2] The dwindling Egyptian pound, falling tax receipts, and increasing public spending have depleted

[1] Asim Ali is a PhD Candidate in the Department of Political Science, University of Western Ontario. Shatha Al-Aswad is an Assistant Vice President for Bank & Sovereign Credit at State Street Corporation. Both are Affiliates of the Sovereign Wealth Fund Initiative at The Fletcher School of Law & Diplomacy, Tufts University. **The authors are grateful to John Nugee, Senior Managing Director, Official Institutions Group, State Street Global Advisors, for comments on an earlier draft.
[2] "Economic Crisis Adds Dangers on Egypt's New Political Path," *The New York Times*, January 12, 2012. Accessible at: http://www.nytimes.com/2012/01/25/world/middleeast/egypts-new-path-complicated-by-economic-problems.html?pagewanted=all.

foreign exchange reserves at $2 billion per month since February 2011.[3] The Egyptian government has been relying on its foreign reserves to fill the financing gap; its foreign reserves, which stood in a comfortable range of US$35 billion at the start of political upheaval in January 2011, have dropped to US $16.4 billion.[4]

Now, the Egyptian government is scrambling for economic solutions in the face of a looming balance of payments crisis and possible sovereign default crisis. Egypt must choose between two seemingly irreconcilable options: *the obvious* or the *innovative*. By following the standard recipe of International Financial Institutions (IFIs) to restore financial health (i.e. in the context of a balance of payment crisis) and accepting restrictive loan conditions and public spending austerity measures, Egypt would be following a traditional route of financial assistance. However, Egypt may continue to experience political unrest, which will stifle efforts to establish political stability.

Here we offer that an *innovative solution*, built upon direct investment in Egypt by GCC sovereign wealth funds, might afford benefits not only to Egypt but also to all the oil and gas exporting countries in the region, especially states in the Persian Gulf region with sovereign wealth funds. Certainly, one would be apprehensive to deploy capital to an investment destination whose future is opaque at best. Nonetheless, we suggest that innovative solutions that include direct investment on the part of Persian Gulf based states in the Egyptian economy, can offer plausible opportunities for both development and investment return.[5] Specifically, an innovative path can facilitate

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[3] "Egypt, January 2012"; International Country Risk Guide, PRS Group

[4] "Egypt: reserves low, tempers high," *The Financial Times*, February 7, 2012. Accessible at: http://blogs.ft.com/beyond-brics/2012/02/07/egypt-reserves-low-tempers-high/#axzz1mNZbX000

[5] The United States has used its financial power and political stature vis-à-vis aid to Egypt, both from within the region and through the IFIs, to achieve certain political objectives. For example, as the FT

creative approaches to address monetary, unemployment, inflation, and infrastructure issues, while relieving some of the socio-economic pressures, which are a source of political stability. In fact, the Persian Gulf based SWFs, with US$160 billion in SWF assets (or 4% of global SWFs assets under management) are well positioned to channel foreign investment into the Egyptian economy,[6] especially in the areas of infrastructure, tourism, and banking. Mahathir bin Mohamad, the Malaysian prime minister who famously declined IMF loans in the face of financial woes, has endorsed this notion of GCC capital to support Egypt and other "Arab Spring" countries.[7]

For Egypt, which is undergoing a political-economic transformation, regional investments on the part of Persian Gulf states would provide a reliable source of long-term capital that can contribute to national development and political stability. Likewise, as long-term investors, Persian Gulf based SWFs are well positioned to become equity stakeholders in dynamic and growth-oriented sectors of the Egyptian economy, particularly in the areas of infrastructure development, banking, and tourism, and consequently contribute in the restructuring of those sectors.

Here, China provides a potential case from which to draw insights. While avoiding European government debt, China has been investing directly or through the China Investment Corporation in the debt-stricken Eurozone. In its drive to continuously diversify its assets for optimal yields, China has been investing in Europe – in a range of

reported, "Egyptian diplomats believe the US used its clout in the region to persuade Gulf countries to withhold aid to Egypt until US citizens prevented from leaving the country pending the trial had been allowed to go." See, "Clinton calls for bilateral aid on Egypt economy," *The Financial Times*, 13 March 2012. Accessible at: http://www.ft.com/cms/s/0/378bb7c2-6c69-11e1-bd0c-00144feab49a.html#axzz1p1ygMRHT

[6] Sovereign Wealth Funds Report, February 2012, TheCityUK & Invesco. p.3

[7] Co-author Shatha Al-Aswad's translation of Malaysian PM's interview with an Arabic newspaper, Al-Ahram. Accessible at: http://www.ahram.org.eg/Al-Ahram-Files/News/127254.aspx.

sectors (engineering, high-tech, utilities, etc.) and infrastructural projects. For example, China recently secured a 25% stake in the electricity sector of financially distressed Portugal. Likewise, China took over a German engineering firm, Putzmeister, for an undisclosed amount. Similarly, China is now a shareholder in the British utility Thames Water. As well, it has bought stakes in the debt-laden Italian luxury yacht maker Ferretti Group.[8]

Following the Chinese approach to investment in Europe, the Persian Gulf states could potentially leverage their SWFs to invest in the Egyptian economy in the areas of infrastructure development, tourism, and a nascent Islamic finance sector.

Initial Attempts at Financial Assistance: Promises, Pledges, and Proffers …

To lend their support to countries – especially Tunisia and Egypt, initially – in the crosscurrents of political and economic convulsions the G8 launched, in 2011, the "Deauville Partnership," at a meeting in Marseille, France. The G8 pledged US$20 billion to countries in the throes of political unrest and assured assistance through financial aid (in the form of development loans, investments, debt relief, and financial guarantees) from multilateral financial institutions, including the IMF.[9] In addition, Kuwait, Qatar, Saudi Arabia, Turkey, and United Arab Emirates joined the Partnership. With the exception of Turkey, all the regional partners have sovereign wealth funds. In

[8] "China snubs debt in European spending spree," *The Sydney Morning Herald*, February 6, 2012. Accessible at: http://www.smh.com.au/business/world-business/china-snubs-debt-in-european-spending-spree-20120206-1r06o.html.

[9] The G8 communiqué also underscored: "We call on the multilateral development banks and regional development funds to foster their coordination, especially at the country-level, and enhance their support to meet the challenges faced by Partnership Countries. The enlarged group of international and regional financial institutions supporting the initiative brings the total amount available for Egypt, Tunisia, Morocco and Jordan in 2011-2013 to $38 billion in support of suitable reform efforts, in addition to resources that could be available from the IMF." Department of Finance, Canada. Accessible at: http://www.fin.gc.ca/n11/11-077-eng.asp.

spite of well-intentioned promises made at the international level, however, overall financial contributions to Egypt remain modest.

The continuous hemorrhaging of foreign reserves, in the face of capital outflows, declining remittances and tourism revenue, has led the interim government to consult the IMF. However, the Supreme Council of the Armed Forces (SCAF), a temporary executive branch comprised of 19 military generals, vetoed plans for a US$3 billion dollar loan from the International Monetary Fund (IMF) in mid-2011. The SCAF-led interim (care-taker) government argued that it was not empowered to negotiate foreign loans and saddle an incoming elected government with foreign debt. As well, the SCAF argued that neighboring states in the Persian Gulf had offered financial assistance comprised of loans, grants and new investments.[10] Saudi Arabia, for example, pledged US$4 billion in financial assistance, the UAE offered US$3 billion, and Qatar assured a US$500 million grant and US$10 billion commitment to invest in the Egyptian economy.[11] However, international and regional donor pledges have not translated into actual tangible assistance, and as of late 2011, only US$1 billion had been disbursed.[12] This has left Egypt little alternative but to approach the IMF for a US $3.2 billion credit

[10] "Egypt Spurns The IMF And Rushes Into The Arms Of Gulf States," *Business Insider*, July 7, 2011. Accessible at: http://articles.businessinsider.com/2011-07-07/politics/30087415_1_imf-aid-international-monetary-fund-social-justice

[11] "Saudi Arabia, Qatar compete on the economy of New Egypt," *Albawaba*, May 31, 2011. Accessible at: http://www.albawaba.com/main-headlines/saudi-arabia-qatar-compete-economy-new-egypt-376052. Some reports suggested some of Persian Gulf based assistance, unlike the IMF loan agreement, was devoid of any documentation or transparency and had the sole purpose of dissuading Egypt from approaching Iran for any assistance. See also "Egypt-Gulf Cooperation Motivated by Strategic Interests," November 17, 2011. Accessible at: http://www.egyptindependent.com/node/515491. See also, "Egypt says Qatar gave $500 mln to help with budget," *Reuters*, October 9,2011. Accessible at: http://af.reuters.com/article/investingNews/idAFJOE79802520111009.

[12] EIU Country Report January 2012.

facility.[13] Certainly, IMF support would provide confidence to foreign investors, including SWF. It would also unlock financing sources from both within the region, especially the Persian Gulf states, and internationally, provided it does not come with standard "conditionalities" appended to IMF loan programs[14]. Thus, as a financing option, structuring such a facility requires caution as traditional conditions would be politically unpalatable and economically destructive in the current socio-political environment in Egypt.

Persian Gulf based SWFs: Opportunity for Capital building and capital diversification through 'Neighborly Investment'

The Persian Gulf based SWFs, along with Asian SWF, made significant financial contributions to Western institutions during the crisis in 2007-2008, even as they incurred heavy losses on their investments. Thereafter they have retreated from western financial markets and shifted their portfolio allocations to emerging markets. The sponsors of Gulf based SWFs also became more targeted in their investments, especially as a result of ongoing political turmoil in the Mid-East region. For instance, to assuage restive sections of their population and maintain political stability, the investment focus shifted to domestic spending, infrastructure development and job creation. Still, as the Persian Gulf based SWFs continue to evaluate their broader investment and diversification strategies, Egypt provides a potential opportunity for Persian Gulf SWFs in three economic areas: *infrastructure investment, tourism, and Islamic finance*.

[13] "IMF deal critical for Egypt, say economists, the *Financial Times*, February 12, 2012. Accessible at: http://www.ft.com/intl/cms/s/0/e38efdf4-5599-11e1-9d95-00144feabdc0.html#axzz1mHaxfAzO

[14] Examples include fiscal austerity; tightening of monetary policy; instituting higher interest rates and taxes; elimination of subsidies; retrenchment of public sector wages and employment; deregulation of state assets

Infrastructure Investment

Egypt provides a lucrative market for *infrastructure investment*. Qatar, for example, has continued to invest in Europe, where sovereign debt crises and economic malaise keep foreign investors away.[15] Qatar, through its SWF, struck a financing deal with European Goldfields, the London-listed company behind large gold-mining projects in Greece. It will lend US$600 million to finance the company's Greek gold mines, in return for a possible 30% stake.[16] Qatar also made acquisitions in a power and utility company in Portugal and Spain, respectively. The Qataris also took a direct role in the most troubled European debtor country – Greece – when it bought 17% of a new entity created by the merger of Greece's Alpha Bank and Eurobank. Earlier it also bought the Turkish arm of Dexia, the struggling French-Belgian lender.

In June 2011, Qatar pledged US$10 billion to invest in several projects to support Egypt's economy, including a stake in US$9 billion port project near the Suez Canal[17]. Pledged assistance to Egypt demonstrates the strategic importance of the country for its Persian Gulf neighbors. Like Qatar, Saudi Arabia, Kuwait, and UAE have made it clear that they foresee changes to deploying their SWF's resources into infrastructure projects and away from concentrating on financial markets. These declared interests can drive benefits to both Egyptians and GCC members. Persian Gulf states investment in Egyptian

[15] For instance Qatar agreed to invest US$7 billion in real estate, energy and tourism sectors in an almost bankrupt, recession-hit Greek economy. According to *The Financial Times*: A memorandum of understanding was signed between George Papandreou, the prime minister, and Sheikh Hamad bin Khalifa al Thani, emir of Qatar, which noted "that Greece is a place that can attract credible investors." See "Athens seeks $7bn investment from Qatar," *The Financial Times,* September 23, 2010. "Accessible at: http://www.ft.com/intl/cms/s/0/fe08c718-c72a-11df-aeb1-00144feab49a.html#axzz1lzlZqELb

[16] "Qatar in $750m European Goldfields deal," *The Financial Times*, October 2, 2011. Accessible at: http://www.ft.com/intl/cms/s/0/fafb43a4-ed0b-11e0-be97-00144feab49a.html#axzz1lzlZqELb

[17] "Qatar Earmarks $10 Billion for Egypt Projects", *The Gulf Business News & Analysis*, June 2011. Accessible at: http://www.thegulfonline.com/Articles.aspx?ArtID=3513.

ports (infrastructure investment), for instance, can help control the quality of and time required for their commodities to be serviced. Turning Suez ports into the one of the busiest and most efficient shipping centers in the world can only help the oil and gas exporting countries to manage their exporting routes efficiently. The case of Singapore is illustrative. Depraved of natural resources, Singapore became an entrepôt[18] and is now one of the world's busiest transshipment hubs, as well as an important regional financial center. This has come with the realization that a free trade economy should be backed by a strong legal structure. The Port of Singapore generates on average ~USD$175 billion[19] while the Suez Canal generates ~USD$2 billion.

Tourism

Tourism – another profit sector of the Egyptian economy – is the second largest source of foreign currency for Egypt after expatriate remittances. Tourism accounted for 6% of GDP and contributed US$13 billion to the national exchequer, in 2010, according to Egyptian Ministry of Finance statistics.[20] Tourism attracts around 13 million visitors to Egypt annually.[21] Each tourist dollar, according to the Egyptian government statistics, generates US$4 or US$5 in income, which suggests a strong impact on incomes and the

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[18] An entrepôt is a trading post where merchandise can be imported and exported without paying import duties, often at a profit. This profit is possible because of trade conditions, for example, the reluctance of ships to travel the entire length of a long trading route, and selling to the entrepôt instead. The entrepôt then sells at a higher price to ships travelling the other segment of the route. In modern times customs areas have largely made such entrepôts redundant.

[19] Maritime and Port Authority of Singapore ,Annual Report, 2010.

[20] "Time to hit the road," *Egypt Today*, Feburary 14, 2012. Accessile at: http://egypttoday.com/news/display/article/artId:217/time-to-hit-the-road-/secId:1/catId:5. See also,"Tourism sector suffers huge losses due to political unrest in Egypt," *Gulf News*, March 11,2011. Accessible at: http://gulfnews.com/news/region/egypt/tourism-sector-suffers-huge-losses-due-to-political-unrest-in-egypt-1.774467

[21] "Tourism sector suffers huge losses due to political unrest in Egypt," *Gulf News*, March 11,2011. Accessible at: http://gulfnews.com/news/region/egypt/tourism-sector-suffers-huge-losses-due-to-political-unrest-in-egypt-1.774467

standards of living of workers in the tourism sectors and other service-oriented sectors of the economy.[22] However, the tourism sector has been adversely affected by the ongoing political unrest in the country. For example, before the uprising began, 16 million tourists were estimated to enter Egypt. Days after the uprising started one million tourists left Egypt. Tourism in Egypt is a lucrative sector for growth and prosperity. As we have seen in Dubai, it is an industry that can bring prosperity to many other industries and sectors in the economy.[23] Still, the tourism sector in Egypt offers a promising venue for the Gulf based SWF investments, especially in the area property ownership around beach resorts areas like the Red Sea region, including Sharm-el-Sheikh, and opportunities in hotel management.

Islamic finance

Lastly, *Islamic finance* is another area with substantial scope for Gulf based financial firms to maximize their investments. Here, Bahrain, the Islamic finance hub in the region, besides Saudi Arabia, could leverage its institutional expertise to assist Egypt with developing a hybrid banking system – Islamic and conventional. As well, it would "socialize" the newly elected Islamist government in Egypt to the moderating ways of Bahraini and Saudi approaches to economic governance, especially in the areas of finance and banking industries. In the North Africa region, Egypt has the highest sharia-compliant assets which account for around 4% of its US$215 billion banking assets.[24] Meanwhile, the Islamic insurance (*takaful*) sector makes up 5 percent of Egypt's US$1.45

[22] The statistics on tourism sector in this section are drawn from Mohieldin, Mahmoud. "Neighborly Investments," *Finance & Development*, Vol. 45, No. 5, December 2008.
[23] "Egypt's Tourism Industry Faces Sharp Reversal," *The New York Times*, 23 February 2011. Accessible at: http://www.nytimes.com/2011/02/24/world/middleeast/24iht-m24late.html
[24] *The World Islamic Banking Competitiveness Report 2011-12*. Ernst & Young. P. 20

billion insurance market and is expected to grow dramatically.[25] For example, some Saudi investors are positioning themselves to establish Sharia-compliant development bank targeted to small and medium size businesses. Currently there are only three Islamic banks - the National Bank for Development, the Faisal Islamic Bank of Egypt and Egyptian Saudi Finance -operating in Egypt. The potential for both Gulf, and Malaysian Islamic banks therefore is attractive.

Conclusion

For the GCC members, “neighborly investment” by the Persian Gulf states in Egypt would be a prudent part of their diversification and development objectives. By focusing capital on establishing tangible stakes in ailing economies[26] they would contribute to political stability by injecting necessary investment and financial capital into these economies. To this end, the GCC and Egypt can mutually benefit by collaborating together. For Egypt, instead of feeding into a non-ending debt cycle with stringent external requirements, its cabinet might look to its own economy and enhance its core competencies in the areas of infrastructure development, tourism, and Islamic finance. The challenges are real and many. However, if they are addressed effectively, the innovative solutions we propose can open for Egypt a path of sustainable economic development, while offering attractive investment opportunities to its Gulf neighbors.

[25] “A new chance in Egypt for Islamic finance,” *Reuters*, April 21, 2011. Accessible at: http://af.reuters.com/article/topNews/idAFJOE73K09Y20110421.
[26] Mohieldin, Mahmoud. “Neighborly Investments,” *Finance & Development*, Vol. 45, No. 5, December 2008.